85-360

No. ____

Supreme Court, U.S.
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IN THE

# SUPREME COURT OF THE UNITED STATES

October Term, 1984

DAVID E. WASSERSTROM,
*Petitioner*

*v.*

MARTIN EISENBERG and ARTHUR NISSEN,
*Respondents*

## PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

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77 pp

## QUESTIONS PRESENTED

1. Whether an attorney involved in an offering of securities has a duty to conduct an investigation into the accuracy of other professionals' reports so that his failure to conduct such an investigation, standing alone, is recklessness (*scienter*) creating civil liability for violation of §10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 of the SEC thereunder?

2. Whether the Court of Appeals violated the doctrine of *Erie R. Co. v. Tompkins*, 304 U.S. 64 (1938) by characterizing an action against an attorney as one for negligent misrepresentation rather than legal malpractice thereby avoiding the firmly-established rule in Pennsylvania that only a client has a cause of action against an attorney for malpractice?

## PARTIES TO THE PROCEEDING

The parties to this proceeding are David E. Wasserstrom, an attorney, and a defendant below, and Martin E. Eisenberg and Arthur Nissen, plaintiffs below.[1]

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1. The following were also parties to the proceedings below: Clarence Rainess & Co., an accounting firm, Charles Lieberman and David Weinstein, who were respectively the general partners of Ark and Cay, and Pelino, Wasserstrom, Chucas & Monteverde, P.C., a professional corporation, all of whom were defendants below. Frederick M. Gagnon and Bernard A. Boyers were named defendants below but were never served. Edward Hershenhorn, the general partner of Bar, was served, but defaulted in appearing. A default judgment has been entered against him.

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## PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

Petitioner David E. Wasserstrom respectfully prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Third Circuit entered on June 28, 1985, vacating the judgment in favor of petitioner on the securities count entered on the jury's verdict and reversing the judgment of United

States District Court Judge Charles R. Weiner granting judgment n.o.v. in favor of petitioner on the negligence claim.

## OPINIONS BELOW

The Opinion of the Court of Appeals has been officially reported as *Eisenberg v. Gagnon*, 766 F.2d 770 (3d Cir. 1985). It is also reproduced in Appendix "A" beginning at P. A-1. The Order Amending Opinion is reproduced in Appendix "B" beginning at P. A-37. The Opinion of United States District Court Judge Charles R. Weiner is not reported. It appears in Appendix "C" beginning at P. A-43.

## JURISDICTION

The Opinion of the Court of Appeals was entered on June 28, 1985. It was amended on July 26, 1985. This Petition is filed within ninety (90) days of the original opinion. The jurisdiction of this Court is invoked under 28 U.S.C. §1254(1).

## STATUTE AND REGULATION INVOLVED

Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. §78j(b), provides as follows:

> "It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange —
>
> "(a) * * *
>
> "(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as

necessary or appropriate in the public interest or for the protection of investors."

Rule 10b-5 of the Securities Exchange Commission, 17 C.F.R. §240.10b-5, provides, in pertinent part, as follows:

"It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange

"(a) * * *

"(b) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading,***"

## STATEMENT OF THE CASE

This petition arises from an action brought by certain purchasers of coal tax shelter investments on behalf of a class of all investors in three limited partnerships known as Ark, Bar and Cay. Plaintiffs contended that private offering memoranda prepared under the supervision of petitioner Wasserstrom and containing a tax opinion letter authored by Wasserstrom contained misleading statements and omitted to state material facts. Plaintiffs claim that they relied upon the alleged misstatements and omissions in purchasing limited partnership interests in Bar and Cay and were damaged in that they lost the amount of their respective investments plus the interest they were required to pay to the Internal Revenue Service when the deductions which they claimed for their investments were disallowed.

Petitioner is an attorney who in 1976 was a shareholder in the firm of Pelino, Wasserstrom, Chucas & Monteverde, P.C., specializing in the areas of tax and

real estate law. At the request of the promoter of certain coal tax shelter investments, Wasserstrom supervised the preparation of the private offering memoranda for the investments and authored the tax opinion letter which was included as an exhibit to the private offering memoranda. The tax opinion letter was addressed to the general partner of each of the three limited partnerships; it was not addressed to the individual limited partner investors. The individual limited partners were not Petitioner's clients.

One of the other exhibits to each private offering memorandum was a mining engineer's report of estimated coal reserves. The mining engineer's report stated on its face that it was an estimate based upon visual inspection only and that core drilling and surface prospecting should be done in order to confirm the estimate of coal reserves contained in the report. The accounting firm of Clarence Rainess & Co. provided a certification, also an exhibit to the private offering memoranda, that certain projections based on the estimate of coal reserves were "not unreasonable." An accountant with Clarence Rainess & Co. testified that he noted that the type face of the mining engineer's report changed in the course of the report. The projections certified by the accountant were merely a mathematical extrapolation of the figures contained in the coal reserve report. The accuracy of that mathematical extrapolation has never been questioned. What has been an issue is the accuracy and validity of the coal reserve report itself. There is no evidence in the record that petitioner or any other defendant had any knowledge that the coal reserve report was in any way inaccurate or invalid.

The private offering memoranda stated repeatedly, in boldface as well as regular type, that the investment described therein was highly speculative in nature. It was expressly stated that there was no assurance that any amount of coal would be recovered.

The jury returned a verdict in favor of all defendants on the claims of securities fraud under §10(b) and Rule 10b-5. The jury found Wasserstrom liable to the plaintiffs on the negligence count and awarded damages to each plaintiff in the amount of his investment plus the interest he paid the IRS in settlement of the disallowance of the tax deductions taken on account of the investment. District Judge Charles R. Weiner of the Eastern District of Pennsylvania granted petitioner's motion for judgment, n.o.v., on the negligence claim, finding that the record clearly showed that the plaintiffs had not relied upon the private offering memoranda in making their investments.

The Court of Appeals vacated the judgment entered on the jury verdict in favor of the defendants on the securities fraud claim and reversed the entry of judgment, n.o.v., in favor of petitioner on the negligence claim.[1]

The Third Circuit's original opinion contained the following language equating the failure of a professional to investigate the basis of another professional's opinion with recklessness:

> ". . .[P]rofessionals, such as accountants, and attorneys who prepare and review opinions for the use of the investing public, and persons who have a special relationship to investors making use of projections, have an affirmative duty to investigate the basis of projections and opinions made and may not simply rely on the opinions or factual submissions of others in reckless disregard of their possible invalidity." Slip Opinion at p. 10; Appendix at A-10.

The original opinion did not cite on this point the prior decision of the Third Circuit in *McLean v. Alexander*,

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1. Judge Weiner denied plaintiff's Motion for class certification. The Court of Appeals vacated that Order and remanded for further proceedings on the issue of whether or not a class should be certified. The class action determination is not a subject of this petition.

599 F.2d 1190 (3d Cir. 1979) in which the Third Circuit had defined "recklessness" under §10(b).

All defendants filed petitions for rehearing. While various grounds were alleged by each defendant, all defendants joined in attacking the above-quoted portion of the opinion as inconsistent with *Ernst & Ernst v. Hochfelder*, 425 U.S. 125 (1976) and the Third Circuit's prior decision in *McLean*. Although the petitions for rehearing were denied, the panel issued an Order Amending Opinion in which the language quoted above was deleted. However, the language inserted in substitution likewise establishes negligence as the basis for §10(b) liability for a professional who reviews the opinion of another professional. In the Order Amending Opinion the Third Circuit propounded this new formulation:

> ". . .When the opinion or forecast is based on underlying materials which on their face or under the circumstances suggest that they cannot be relied on without further inquiry, then the failure to investigate further 'may support an inference that when [the defendant] expressed the opinion it had no genuine belief that it had the information on which it could predicate that opinion.' *McLean v. Alexander*, 599 F.2d at 1198.
>
> . . .Although Rainess claims to have relied upon a coal reserve report by J. D. Brackenrich, an engineer with significant coal experience and Leiberman and Weinstein also contend that this report gave all defendants a reasonable basis for the projections, a jury could find that there were sufficient indicia of unreliability in that report that Rainess, and possibly other defendants, should have inquired further and that failure to do so was in reckless disregard of the duty to assure that there was a reasonable basis for the assumptions."

Order Amending Opinion at pp. 4-5; Appendix at A-40, 41.

The Court went on to note that the report stated on its face that it was an estimate based upon visual inspection only and that core drilling and surface prospecting should be done to confirm the estimate. The Court further pointed out that nothing in the report suggested that it could or should be used as an estimate in a securities prospectus. (No authority is cited for the novel requirement that a report must be expressly done for a securities prospectus). The Court further cited testimony by the engineer who prepared the report that it had been altered to increase the amount of coal reserves. This testimony is irrelevant to the issue of recklessness since there is absolutely no showing that any defendant had the information supplied by that testimony available to him at the time he acted on the offering.[2] Finally, the Court noted that an accountant with defendant Rainess admitted that he noted that the type face changed in the course of the engineer's report. In this connection the Court noted that Rainess made no independent investigation of the accuracy of the report.

The law of Pennsylvania is well settled that only a client may maintain an action against an attorney for legal malpractice. *Guy v. Liederbach*, 501 Pa. 47, 58, 459 A.2d 744 (1983) The plaintiffs were not Wasserstrom's clients. However, having employed Wasserstrom's status as an attorney to impose upon him an unprecedented "duty to inquire" under §10(b) of the Exchange Act, thus subjecting him to liability for "recklessness", the Third Circuit went on to declare Wasserstrom's status as an attorney to be irrelevant to the negligence claim against him. The Court avoided application of the Pennsylvania privity requirement by designating the claim as

2. The Court omitted reference to the fact that the engineer was confronted on cross-examination with a report, *admittedly signed by him*, showing a coal reserve estimate identical to the one contained in the prospectus.

one for negligent misrepresentation rather than for legal malpractice.

## REASONS FOR ALLOWANCE OF THE WRIT

### I. THE JUDGMENT IS IN CONFLICT WITH A PRIOR OPINION OF THIS COURT, A PRIOR OPINION OF THE THIRD CIRCUIT AND THE DECISIONS OF AT LEAST THREE OTHER COURTS OF APPEALS.

#### A. The Conflict With This Court's Opinion In *Hochfelder* And The Third Circuit's Own Prior Opinion in *McLean*.

The Third Circuit's opinion creates a duty under §10(b) of the Exchange Act for a professional involved in an offering of securities to conduct an independent investigation of the basis of another professional's opinion upon which he intends to rely. Failure to perform that duty of inquiry can be the basis for a finding of "reckless conduct" or *scienter*. In *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976) this court held that a private cause of action for damages will not lie under §10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder in the absence of " 'scienter'-intent to deceive, manipulate, or defraud." 425 U.S. at 193. Negligence, the Court held, is not enough to impose liability under §10(b).

The Court expressly did not address in *Hochfelder* the question whether "in some circumstances, reckless behavior is sufficient for civil liability under §10(b) and Rule 10b-5." 425 U.S. at 194, n. 12. Since *Hochfelder* all but one of the Courts of Appeals have addressed the question whether recklessness is enough to establish *scienter* under §10(b) and have held that recklessness is sufficient to establish *scienter*.[3]

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3. The Court's footnote suggested only that recklessness may be sufficient for civil liability "in some circumstances." None of the

The Court of Appeals for the Third Circuit was one of the first to declare recklessness sufficient after *Hochfelder*. See, *Coleco Industries, Inc. v. Berman*, 567 F.2d 569, 574 (3d Cir. 1977), *cert. denied*, 439 U.S. 830 (1978). In *McLean v. Alexander*, 599 F.2d 1190, 1197 (3d Cir. 1979) the Third Circuit adopted the following definition of recklessness from the opinion of the Seventh Circuit in *Sundstrand Corp. v. Sun Chemical Corp.*, 553 F.2d 1033, 1045 (7th Cir.), *cert. denied*, 434 U.S. 875 (1972):

> "[R]eckless conduct may be defined as. . . highly unreasonable [conduct], involving not merely simple, or even inexcusable negligence, but an extreme departure from the standards of ordinary care, and which presents a danger of misleading buyers or sellers that is either known to the defendant or is so obvious that the actor must have been aware of it."

The Court of Appeals' decision in the present case does precisely what *Hochfelder* enjoins: it makes mere negligence enough to impose civil liability under §10(b). The Third Circuit's emasculation of *Hochfelder* is particularly egregious in this case because it involves the liability of professionals, attorneys and accountants.

In substance all that the Third Circuit relied upon to constitute a *prima facie* showing of reckless behavior is a statement on the face of the engineer's report that it is only an estimate based upon visual inspection (*i.e.*, the basis for the estimate is fully disclosed) and that the typeface in the report changed (also obvious from the report, which was an exhibit to the private offering memoranda). Clearly, neither of those factors constitutes knowledge on the part of any defendant that the estimates were inaccurate; nor do they constitute a danger "so obvious" that the defendants must have been aware

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Courts of Appeals which have addressed the question of recklessness seem to have considered the question whether recklessness might be enough in some circumstances but not in others.

of it. In fact, the Order Amending Opinion does not cite a single fact which was known to the professionals but not to the investors. The Third Circuit imposes upon professionals a duty to investigate beyond another professional's report at the peril of being found guilty, not of negligence or even gross negligence, but of reckless behavior amounting to *scienter*, sufficient for liability for fraud under the federal securities laws.

The Third Circuit cites no evidence whatsoever of any knowledge by any defendant that the coal reserve report was inaccurate or false in any way and the record contains no such evidence. The opinion establishes a new duty on the part of professionals to investigate beyond the face of reports of other experts upon whom a professional relies. If such a duty exists, it is a duty of professional responsibility the failure to perform which constitutes negligence.[4] It is not fraud and it is not recklessness by any reasonable definition of the term.

There is no "duty of inquiry" under §10(b) after *Hochfelder*. Indeed, the very concept of a duty to inquire presupposes a state of lack of knowledge. Duty to inquire is a negligence concept. It has no place in a determination of *scienter* under §10(b). What is required is either

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4. As we argue below, the Third Circuit also violated the doctrine of *Erie R. Co. v. Tompkins*, 304 U.S. 64 (1938) by shifting ground on the negligence claim against Wasserstrom, designating the claim as one for negligent misrepresentation rather than attorney malpractice, in order to avoid the Pennsylvania law that only a client has a cause of action against an attorney for malpractice. Thus, in order to impose liability under the securities laws Judge Sloviter relies upon the status of Wasserstrom as an attorney to create a new "duty" to investigate beyond the face of the reports of other experts whereas she avoids the limitation on suits against professionals in Pennsylvania by declaring that Wasserstrom's status as a professional is irrelevant to imposing liability upon him for negligence. Clearly, the objective is to impose liability upon Wasserstrom in any way that it can be done regardless of governing rules of law established by this Court and the Pennsylvania Supreme Court.

knowledge or the presence of factors which establish that the actor must have been aware of the misleading nature of the statement that was made.

The Third Circuit failed to distinguish between the concept that a statement of a projection or opinion is a false or inaccurate statement if made without any reasonable basis to believe that it is true (as, for example, the president of a company announcing that he projects that sales will increase next year by twenty percent when he has no evidence whatsoever upon which to base such a prediction) and the situation where a professional has before him the opinion of another professional making an estimate or projection. In that situation the other professional's opinion in and of itself provides a reasonable basis for the second professional's statement based upon it. Only if there were evidence that the second professional knew or must have known that the opinion upon which he was relying was without any basis in fact could §10(b) liability be imposed. No such evidence exists in this case. Nor does the Court of Appeals claim that there is such evidence. The only items pointed to by the Court of Appeals are obvious from the face of the report. There is no concealment from the investor of any information which is available to the attorney.

That the opinion by the Third Circuit goes far beyond its own earlier opinion in *McLean* and is in conflict with the *Hochfelder* decision by this Court is made clear by reference to the *McLean* opinion, in which the Third Circuit expressly stated that facts similar to those present here constitute mere negligence, insufficient to impose liability under §10(b). In *McLean* the Court said the following:

> "If we were applying a negligence standard we could affirm a finding that given the one month discrepancy in the due dates between the invoice and purchase order, the late issuance of the invoice, the ambiguity in the telegraphic confirmation, Schiavi

> [the accountant] should have made further inquiry of management or of L. B. Smith before concluding that the account receivable was genuine. But we can not hold that these factors, standing alone, were evidence that C & S was aware that it was without sufficient knowledge to form that opinion. *Such a holding would obliterate the distinction between tortious conduct requiring* scienter *which the Hochfelder construction of §10(b) demands, and negligence, which Hochfelder found insufficient. McLean v. Alexander*, 599 F.2d at 1200, (emphasis added).

Reference to the opinion in *Sanders v. John Nuveen & Co.*, 524 F.2d 1064 (7th Cir. 1975), *vacated and remanded*, 425 U.S. 929 (1976), also demonstrates that the Third Circuit's opinon is contrary to the holding of *Hochfelder*. That case involved an underwriter who had relied upon financial statements certified by a public accounting firm, which was later discovered to be engaged in a course of fraudulent deception together with the issuer. The Seventh Circuit affirmed the holding of the District Court that the underwriter was liable for violation of §10(b) on the theory that it breached a duty to make reasonable inquiries into the basis for the accountant's certification that would have led to the discovery of the issuer's fraud. 524 F.2d at 1066. The Court held that the underwriter's relationship with the issuer gives the underwriter access to facts not equally available to members of the public and that the underwriter makes an implied representation that he has met the standards of his profession in investigating the issuer. 524 F.2d at 1070. On petition for certiorari, this Court vacated the Seventh Circuit's decision in *Sanders* in light of the *Hochfelder* opinion. On remand the Seventh Circuit exonerated the underwriter from liability and stated as follows:

> "[I]n view of the Supreme Court's analysis in *Hochfelder* of the statutory scheme of implied private remedies and express remedies, the definition of 'reckless behavior' should not be a liberal one lest any discernable distinction between 'scienter' and 'negligence' be obliterated for these purposes. We believe 'reckless' in these circumstances comes closer to being a lesser form of intent than merely a greater degree of ordinary negligence. We perceive it to be not just a difference in degree, but in kind." 554 F.2d. at 793.

The Third Circuit relies upon two cases for its creation of a new duty of professionals. The first, *Chris-Craft Industries, Inc. v. Piper Aircraft Corp.*, 480 F.2d 341 (2d Cir. 1973) is a pre-*Hochfelder* decision involving the liability of corporate insiders in a take-over situation. Likewise, the second case relied upon, *Marx v. Computer Sciences Corp.*, 507 F.2d 485 (9th Cir. 1974), is a pre-*Hochfelder* decision also involving the liability of the issuer of securities, not a professional. The Court in *Marx* applied a "flexible duty standard" which it defined as including elements of a claim for common law fraud and some of the elements peculiar to a claim for negligence. Since *Hochfelder* clearly eliminates negligence as a basis for liability, the *Marx* decision must be considered questionable after *Hochfelder*. Because of these distinctions between the pre-*Hochfelder* decisions upon which the Third Circuit relied and this case, and principally the fact that neither of them involved the liability of a professional for relying upon the opinion of another professional, the Third Circuit's newly created duty of a professional is utterly without support in the cases cited or in any other case that petitioner has found.

The Third Circuit Court of Appeals is bound by this Court's decision in *Hochfelder*. Clearly, an express decision by the Third Circuit that negligent conduct is sufficient to establish scienter under the securities laws

would be in blatant disregard of this Court's *Hochfelder* decision. The decision of the Third Circuit Court of Appeals in this case is tantamount to doing just that in that it defines reckless conduct (which itself has not yet been declared by this Court to be a sufficient basis for *scienter*) in such a way as to encompass what is clearly mere negligence, i.e., the failure to investigate the basis of another professional's report. The rule of *Hochfelder* is equally undermined.

### B. The Conflict With The Decisions Of Other Courts Of Appeals.

It is clear from a review of opinions by other Courts of Appeals that the Third Circuit has carried the definition of recklessness far beyond what any other court of appeals has done, and in fact, its opinion is in direct conflict with the decisions of every other court of appeals that has confronted the issue of what constitutes "recklessness" by a professional. In *The Pegasus Fund, Inc. v. Laraneta*, 617 F.2d 1335 (9th Cir. 1980) the Ninth Circuit held that the claims against an accounting firm, which consisted of failure to discover certain interlocking relationships and other "warning details", amounted to no more than mere negligence or malpractice and did not, therefore, support a claim under §10(b). Summary Judgment in favor of the accounting firm was affirmed. The court discussed *Hochfelder*, making reference to the Court's conclusion that liability under §10(b) is limited to those who act "other than in good faith." The court interpreted this to mean the following:

> "By referring to the good faith defense, the Court meant, we believe, to reinforce and clarify the distinction of ordinary malpractice resting on negligence, on the one hand, and fraud, on the other. We agree with the appellee that the issue before us is whether the mutual funds have alleged anything more than ordinary malpractice.

We think they have not." 617 F.2d at 1340.

The Court went on to agree with the Seventh Circuit's statement in *Sanders* that §10(b) recklessness is closer to a lesser form of intent than a greater degree of negligence. *Id.*

In *Stokes v. Lokken*, 644 F.2d 779 (8th Cir. 1981) the Eighth Circuit affirmed a summary judgment in favor of a lawyer claimed to have aided and abetted a violation of §10(b). The court held that the attorney's conduct fell short of any reasonable formulation of the requisite legal standard for *scienter*. The court noted: (1) the absence of any knowledge on the part of the attorney that his opinion was incorrect; and (2) that the opinion was qualified, noting the possibility that others might disagree with it, resulting in contingent liabilities. The court found that even though the corporate officer upon whom the attorney had relied for his facts was a convicted felon that did not make the attorney's reliance upon the officer's statements improper. The court said:

> "But the issue here is not whether Lokken acted ethically, or even negligently, but whether he acted knowingly (which even plaintiffs do not claim) or with reckless disregard of the correctness *vel non* of the opinion he was giving. In the present case, moreover, we are unable to see anything unethical in *Lokken's* conduct. To impose a standard of independent factual inquiry in these circumstances would make it unreasonably difficult for clients to obtain expeditious legal advice, or for lawyers to maintain a busy practice. 644 F.2d at 783, n. 3.

In *Croy v. Campbell*, 624 F.2d 709 (5th Cir. 1980), the plaintiffs brought suit against their attorney, who acted as a tax adviser. The attorney arranged for plaintiffs to invest in a tax shelter and in that connection prepared estimates and projections as to the potential tax

liability of plaintiffs. In preparing this projection the attorney relied on a sales brochure which contained certain financial information about the project. Plaintiffs contended, *inter alia*, that the attorney's "failure to make a financial investigation demonstrated 'recklessness' under §10(b)." *Id.* at 715. The Court found that:

> "The mere fact that Campbell [the attorney] made a tax analysis based upon the information presented to him was not an 'extreme departure from the standards of ordinary care.' Nor can we say that the representations made were not without a reasonable basis in fact. *Id.* (citation omitted).

No case has been found in which any Court of Appeals imposed §10(b) liability on a professional (or anyone else) for a mere failure to inquire after *Hochfelder*.

## II. THE QUESTION OF A PROFESSIONAL'S LIABILITY FOR "RECKLESSNESS" UNDER §10(b) IS AN IMPORTANT QUESTION OF FEDERAL LAW WHICH SHOULD BE SETTLED BY THIS COURT.

The *Hochfelder* decision is now almost ten years old. The question left open in *Hochfelder*, i.e., whether "in some circumstances" recklessness would be sufficient to impose civil liability for violation of §10(b), has been considered by all but one of the Courts of Appeals. No other Court of Appeals has ever equated professional malpractice with *scienter*. In fact, as shown above, several have expressly rejected that idea. The Third Circuit has expanded the definition of recklessness to the point where it has negated the holding of *Hochfelder*. If the *Hochfelder* decision is to retain vitality, this Court must step in to declare whether, and in what circumstances, recklessness is enough to impose civil liability, at least where professionals are involved.

The Third Circuit has made professionals guarantors of the actual correctness of the opinions of other professionals upon whom they rely in connection with an offering of securities. The Court has posited for the first time a "duty to assure that there was a reasonable basis for the assumptions [contained in another professionals opinion]". The earlier decision by the Third Circuit in *McLean*, cited as the basis for this duty, does not in fact create such a duty. Instead, *McLean* establishes as the standard for recklessness that the actor "must have been aware" of the misleading nature of the statement. The "duty to assure that there was a reasonable basis" for other professionals' opinions is new; it eliminates from civil liability under §10(b) any requirement of intent to deceive, manipulate or defraud.

Also eliminated from the requirements for §10(b) liability by the Third Circuit's opinion is any element of falseness or omission of a material fact. The Third Circuit specifically states in the Order Amending Opinion that a *lay jury* could find that the report contained sufficient indicia of unreliability to impose this newly created duty to investigate upon the professional reviewing it. The "indicia of unreliability" were obvious from the face of the private offering memoranda. Apparently, the suggestion is that a lay jury could find that there were indications of unreliability,[5] but the plaintiffs, who were sophisticated investors, could not detect these indicia of unreliability. Nothing is cited by the Third Circuit in the way of superior knowledge possessed by Petitioner or any of the other professionals with respect to the engineer's report. There is absolutely no showing in the record that the professionals had any facts beyond the facts which the Court relies upon, which were obvious from the face of the report. The effect of the opinion is to eliminate the

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5. It may be that few, if any, members of a lay jury will have bought any securities, much less highly speculative tax shelter investments.

substance of §10(b) liability, which is the making of a false or misleading statement or the omission of a material fact rather than the mere making of an inaccurate statement.

By giving a lay jury the final say in whether a professional has a duty to investigate further the opinion of another professional and whether that duty has been discharged, based only on the jury's review of that opinion, the Third Circuit has subjected all professionals involved in the offering of securities to the risk of having their professional work reviewed and condemned, in the form of a verdict imposing liability for violation of the federal securities laws, by persons who have no training in the professional's field.

## III. THE COURT OF APPEALS VIOLATED THE DOCTRINE OF *ERIE R. CO. V. TOMPKINS*, 304 U.S. 64 (1938) BY IMPOSING LIABILITY UPON AN ATTORNEY TO A NON-CLIENT CONTRARY TO SETTLED PENNSYLVANIA LAW.

Having subjected Wasserstrom to a newly created duty as a professional (attorney) to investigate the opinion of another professional, the Court of Appeals went on to subject Wasserstrom to negligence liability to a non-client by declaring his status as an attorney to be irrelevant to the issue. The record clearly shows that Wasserstrom acted as an attorney in connection with the offering of the coal tax shelters. He supervised the preparation of the offering memoranda and authored the tax opinion contained therein. It was the coal report contained as an exhibit to the offering memorandum upon which the Court of Appeals relied to find a misleading statement.[6]

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6. The Court of Appeals said:

"Plaintiff's theory, presented in their amended complaint and in

The Court of Appeals' opinion subjects professionals to guarantor liability to investors. If a professional fails to discharge his newly-created duty to investigate the opinions of other professionals, he is at risk of a jury concluding that he was "reckless" and therefore guilty of *scienter* under the securities laws. He is likewise exposed to a claim of liability to the world for negligent misrepresentation notwithstanding firmly established state law that requires privity in order to maintain an action for legal malpractice against an attorney. The Court of Appeals' opinion, taken as a whole, leaves a professional no reasonable chance of avoiding liability to persons who invest in a venture that goes sour.

The Court of Appeals' opinion means that any professional engaged in professional work on an offering of securities cannot feel reasonably secure against potential liability *for the opinions of others* unless he thoroughly investigates the other expert's opinion in a field which, almost by definition, is not his field. For example, a lawyer who relies upon the opinion of a public accounting firm without himself investigating the basis for that opinion places himself at an unreasonable risk of liability for any inaccuracies in that accountant's opinion. Indeed, it might be considered negligence *per se* for a lawyer to attempt to practice accountancy and *vice versa*. Yet, the Court of Appeals has imposed upon lawyers the *obligation* to act as super-accountants and upon accountants to act as super-mining engineers, etc. The only rational

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their opening and closing statements, was that Wasserstrom *deceived* them in a business transaction in which he had a pecuniary interest." (Emphasis added)

The jury's verdict exonerating Wasserstrom on the claims of securities fraud clearly shows that the jury concluded that Wasserstrom did not deceive anyone. Yet the Court of Appeals relies upon this alleged *deceit*, rejected by the jury, to support a cause of action against Wasserstrom for *negligence*. Moreover, the Court of Appeals relies upon plaintiff's unproved *theory*, citing only the amended complaint and the opening and closing statements.

way for a professional to protect himself would be to hire a second expert to investigate the opinion of the first expert. Who will pay for the second expert, the professional who is attempting to protect himself against liability or the issuer? No doubt, the investing public will ultimately pay for the second and third echelons of experts hired to protect the first echelon of experts from liability.

The Opinion blatantly disregards the settled law of Pennsylvania with respect to the liability of attorneys. Through the device of characterizing the appellants' negligence claim as a negligent misrepresentation claim instead of a legal malpractice claim, the Third Circuit has avoided the clear, firm and often-stated requirement of the Pennsylvania Supreme Court that only a person who is in privity with a lawyer may maintain a cause of action against him for malpractice. *Guy v. Liederbach*, 501 Pa. 47, 58, 459 A.2d 744 (1983); *Smith v. Griffiths*, 476 A.2d 22 (Pa. Super. Ct. 1984); *Zeffiro v. First Pennsylvania Bank, N.A.*, 566 F. Supp. 1391, 1392 (E.D. Pa. 1983).

In *Guy v. Liederbach, supra*, the Pennsylvania Supreme Court held unequivocally that a "plaintiff must show an attorney-client relationship or a specific undertaking by the attorney furnishing professional services . . . as a necessary prerequisite for maintaining . . . [a suit against an attorney] on a theory of negligence." 501 Pa. at 58. This requirement cannot be avoided merely by mischaracterizing a professional malpractice claim as one for negligent misrepresentation. If it could be, the privity requirement would be meaningless.

Judge Bechtle, in *Zeffiro v. First Pennsylvania, supra*, cited *Guy v. Liederbach, supra*, in rejecting a similar attempt by a third-party plaintiff to hold a law firm liable for intentionally or negligently misrepresenting the existence of security for a debenture. That Court held that the claim was in effect a legal malpractice claim by a non-client for the alleged failure of the law firm to

take the necessary steps to ensure protection of the non-client's interests. Summary judgment was granted in favor of the law firm for lack of privity between the firm and the third party plaintiff. Wasserstrom, like the third-party defendant in *Zeffiro,* never undertook to perform any service for the parties now charging him with professional negligence.

Under the applicable law, for appellants to prevail on their negligence claim against Wasserstrom, they were required to show that they were in privity with him. This they failed to do. Moreover, Wasserstrom undertook no special services for the plaintiffs. Indeed, he never had any contact with them before they made their investments.

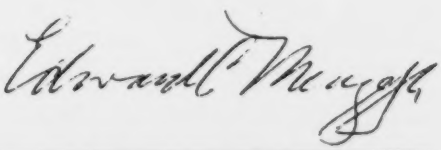
*Mallis v. Bankers Trust Co.*, 615 F.2d 68, 82-83 (2d Cir. 1980), *cert. denied,* 449 U.S. 1123 (1981), cited by the Third Circuit in rejecting a privity requirement, is inapposite. In that case there was no question that the claim was properly one for negligent misrepresentation, since the alleged tortfeasor was a bank and not an attorney providing legal services.

In summary, the Court erred in reversing the judgment n.o.v. granted by the District Court by misapplying Pennsylvania law with respect to the negligence claim against Wasserstrom. Accordingly, this Court should grant review in order to preserve the integrity of *Erie* doctrine and check the imposition of overbroad liability upon professionals by reinstating the judgment n.o.v. in favor of Wasserstrom.

## CONCLUSION

For the reasons stated herein, the writ of certiorari should be allowed.

Respectfully submitted,



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# APPENDIX

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

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Nos. 84-1214, 84-1225, 84-1261

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MARTIN EISENBERG and ARTHUR NISSEN,
on behalf of themselves and all
others similarly situated

v.

FREDERICK M. GAGNON, BERNARD A. BOYERS,
DAVID E. WASSERSTROM, CHARLES LIEBERMAN,
EDWARD HERSHENHORN, DAVID WEINSTEIN,
JOHN W. PELINO, MORRIS L. CHUCAS, TOM P.
MONTEVERDE, WASSERSTROM & CHUCAS, and
PELINO, WASSERSTROM, CHUCAS &
MONTEVERDE, P.C.

v.

GELROD, FOX and CO., CLARENCE RAINESS &
CO., SEIDMAN and SEIDMAN, GRUNTAL and CO.,
MARVIN WELSCH and JACK PANICH

MARTIN EISENBERG AND ARTHUR NISSEN,
*Appellants*
in Nos. 84-1214 &
84-1225

DAVID E. WASSERSTROM,
*Cross-Appellant*
in No. 84-1261

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On Appeal from the United States
District Court for the
Eastern District of Pennsylvania
(D.C. Civil No. 82-5051)

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Argued: February 4, 1985
Before: SEITZ, GIBBONS and SLOVITER,
*Circuit Judges*
(Opinion filed June 28, 1985)

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**OPINION OF THE COURT**

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SLOVITER, *Circuit Judge*.

I.

*FACTS AND PROCEDURAL HISTORY*

Plaintiffs Martin Eisenberg and Arthur Nissen were investors in two limited partnerships, Bar Associates (Bar) and Cay Associates (Cay), which were part of a series of limited partnerships designed as tax shelters. Their investment proved worthless and, moreover, the Internal Revenue Service eventually disallowed any deductions beyond their actual monetary loss. Plaintiffs' principal allegation has been that defendant David Wasserstrom, an attorney, together with Frederick Gagnon and Bernard Boyers, orchestrated a scheme to sell securities in worthless coal rights as purported tax shelters while concealing that they themselves would take the lion's share of the proceeds. As further developed in discovery and at trial,

plaintiffs contended that Wasserstrom had, prior to the organization of the limited partnerships, negotiated the purchase of Cannon Coal Company (Cannon) by the Seah Corporation, of which Wasserstrom was president and a director, for $400,000 in late 1975. Cannon's principal asset was its leasehold on 3,200 acres of West Virginia coal property. Wasserstrom, Gagnon and Boyers then allegedly conspired in establishing six virtually identical limited partnerships that would each sublease 400 acre parcels of this property from Cannon for an "advanced royalty" from each of $2,225,000, of which $475,000 was payable in cash and $1,750,000 in non-recourse notes. Thus, the bulk of the property purchased for $400,000 was resold within a few months for a total of $2,850,000 in cash and $10,500,000 in non-recourse notes.

Wasserstrom, Gagnon and Boyers were alleged to have recruited as nominal general partners for three such limited partnerships, Ark Associates (Ark), Bar and Cay, defendants Charles Lieberman, Edward Hershenhorn and David Weinstein who distributed offering memoranda for the partnerships without revealing that those partnerships were in fact controlled by and benefitted Wasserstrom, Gagnon and Boyers. Plaintiffs claim that the offering memoranda, allegedly composed by Wasserstrom, Gagnon and Boyers, were false and misleading as to the coal reserves and feasibility of coal recovery.

The offering memoranda included a tax opinion written by Wasserstrom and issued under the name of Wasserstrom's law firm, Pelino, Wasserstrom, Chucas & Monteverde (PWC&M), that allegedly misrepresented that the IRS would allow the deduction of large advanced royalty payments by non-recourse notes. The memoranda also contained a statement by the defendant accounting firm of Charles Rainess & Co. (Rainess) that the assumptions underlying the

partnerships' projections were "not unreasonable." Plaintiffs claimed that Wasserstrom and the accountants knew there was no reasonable basis for these assumptions.

Wasserstrom, Gagnon and Boyers allegedly concealed from investors their own interests and those of general partners Lieberman, Hershenhorn and Weinstein in the sale of the partnerships and also concealed that Wasserstrom's law firm received what are claimed to be excessive legal fees for the preparation of the partnerships.

The complaint alleges that plaintiffs and those similarly situated were fraudulently induced to invest more than $1,400,000 in Ark, Bar and Cay, which money was in fact divided by some defendants, resulting in a complete loss on the investments and the disallowance of deductions by the IRS. Plaintiffs claimed these facts demonstrated intentional misrepresentations and omissions in connection with the sale of securities in violation of Section 10(b) of the Securities and Exchange Act of 1934, 15 U.S.C. § 78j(b) (1982), and Rule 10b-5 promulgated thereunder, 17 C.F.R. § 240.10b-5 (1985), and constituted a pattern of racketeering activity and a conspiracy to commit such activity in violation of the Racketeer Influenced and Corrupt Organizations Act (RICO), 18 U.S.C. §§ 1962(c) and 1962(d) (1982). Finally, plaintiffs alleged counts under state common law, including one for defendants' negligent misrepresentations in recommending and soliciting investments in enterprises in which they had an interest.

In the period before trial, the district court denied defendants' motions to dismiss the first amended complaint, *see Eisenberg v. Gagnon*, 564 F. Supp. 1347 (E.D. Pa. 1983), denied plaintiffs' motion for class certification, and gave plaintiffs leave to file a

third amended complaint stating claims against Rainess and its alleged successor in interest, Seidman & Seidman (Seidman). At the trial, defendants were attorney Wasserstrom, his former law firm PWC&M, general partners Lieberman and Weinstein, and the Rainess and Seidman accounting firms. Defendants Gagnon and Boyers were not served and were therefore dismissed. A default judgment was entered against Edward Hershenhorn, general partner of Bar.

The jury was presented with a special verdict form asking it to decide the securities law, RICO, and negligence claims separately as to each plaintiff and defendant. The jury found for plaintiff Eisenberg and against defendants Wasserstrom and Weinstein on the state law negligence claim; for plaintiff Nissen and against defendant Wasserstrom on the same theory; but for defendants on all other claims. After a separate damages trial, the same jury awarded damages to Eisenberg of $12,200 against Wasserstrom and $6,100 against Weinstein, and to Nissen of $23,000 against Wasserstrom.

The parties, following the court's instruction, had filed post-trial motions prior to the damages trial which it ruled on thereafter. The district court granted Wasserstrom's and Weinstein's motion for judgment n.o.v. on liability, concluding that there was insufficient evidence upon which a jury could find reliance by plaintiffs on the offering materials.

Plaintiffs appeal from the district court's orders entering judgment for all defendants on jury verdicts under federal securities laws, entering judgment on the jury verdict for defendant PWC&M under Pennsylvania common law of negligent misrepresentation, and entering judgment n.o.v. for Wasserstrom and Weinstein on the common law claim of negligent misrepresentation. Appellants also seek reversal of the district court's orders denying class

certification and denying their motion to compel production of certain documents. Wasserstrom, as a protective matter, cross-appeals from the court's denial of his motion for a new trial.[1]

II.

*FEDERAL SECURITIES CLAIMS*

We consider first the plaintiffs' claim that defendants violated § 10(b) of the Securities and Exchange Act of 1933, 15 U.S.C. § 78j (1982), and Rule 10b-5, 17 C.F.R. § 240.10b-5 (1985), promulgated thereunder, which prohibit misrepresentations and misleading omissions in connection with the sale of securities. The jury found for defendants on these claims. Appellants argue that the district court erroneously refused to instruct the jury that fraudulent projections were actionable and that the district court gave misleading instructions on the requisite state of mind.

A. *Fraudulent Projections*

Plaintiffs requested that the district court instruct the jury that fraudulent financial projections used in

---

1. Defendant Seidman does not participate on appeal. Appellees Lieberman and Rainess contend that plaintiffs' appeal is untimely as to them because judgment was entered in their favor on liability on February 1 before the trial on damages and no appeal was taken within 30 days. *See* Fed. R. App. P. 4(a)(4). Absent certification under Fed. R. Civ. P. 54(b), plaintiffs could not have appealed a judgment final as to some but not all defendants. The appeal was taken from final judgment as to all parties. Seidman and Rainess also contend that appellants abandoned their claim against them because their notice of appeal does not refer to the February 1 judgment. We disagree. Appellants' Notice of Appeal clearly goes to the rulings and instructions concerning the liability of these two defendants, *see* Fed. R. App. P. 3(c), and hence the appeal is timely as to all appellees.

the sale of securities are actionable under Section 10(b). The proposed instruction, derived from 3 E. Devitt & C. Blackmar, *Federal Jury Practice and Instructions* § 98.11 (3d ed. 1977), was as follows:

> Projections and financial forecasts made with a reasonable basis are not made misleading merely because they may ultimately be proven incorrect.
>
> A projection or a forecast may constitute a basis for plaintiffs' verdict if, but only if, it be proved by a preponderance of the evidence that at the time the forecast or projection was made, the defendants either
>
> (1) did not believe that the forecast or projection was reliable, or
>
> (2) had reason to believe that the forecast or projections were not reliable.
>
> If you find defendants had reason to believe that the projection was not reliable, you should find that they issued a misleading statement.

Appellees agree that fraudulent projections are actionable under § 10(b) and Rule 10b-5. There is considerable authority that projections, forecasts and opinions are actionable as misleading in a variety of circumstances. *See First Virginia Bankshares v. Benson*, 559 F.2d 1307, 1314 (5th Cir. 1977), *cert. denied*, 435 U.S. 952 (1978); *Gottreich v. San Francisco Investment Corp.*, 552 F.2d 866, 867 (9th Cir. 1977); *Marx v. Computer Sciences Corp.*, 507 F.2d 485, 489-90 (9th Cir. 1974); *SEC v. Okin*, 137 F.2d 862, 864 (2d Cir. 1943); R. Jennings & H. Marsh, *Securities Regulation* 880-85 (5th ed. 1982); Jacobs, *What is a Misleading Statement or Omission under Rule 10b-5 ?*, 42 Fordham L. Rev. 243, 279-87 (1973). *See also Sharp v. Coopers & Lybrand*, 649 F.2d 175,

184-85 (3d Cir. 1981), *cert. denied*, 455 U.S. 938 (1982). As presented to the jury, the offering memoranda contained allegedly fraudulent projections in the tax opinion letter supporting the view that the IRS would consider the investments as valid tax shelters, and in the projections of coal reserves and likely ability to mine them.

The district court refused to give any instruction pertaining to projections or forecasts, but instead emphasized that plaintiffs must establish that representations of "existing fact" are untrue. In relevant part, the court's instruction was that:

> A "fraudulent misrepresentation" . . . means a representation that *an existing fact is true*, it being known to the person making said representation that *the facts represented to exist do not in fact exist* and that said representation is false. A fraudulent misrepresentation may be said to be the intentional misstatement of a person as to the *truth of an existing fact*, it being then known to the person making said statements that the facts represented to be true are false.
>
> [P]laintiff must prove by preponderance of the evidence that the defendant stated material facts which he knew to be false, or knew of the existence of material facts which were not disclosed and should have realized their significance in the making of an investment decision . . . .
>
> . . . .
>
> Let me discuss what a material fact is . . . . [It] is one that a reasonable man would deem important in determining whether or not to purchase a limited partnership interest. An omitted fact is material if there is a substantial

> likelihood that a reasonable person would consider it important in deciding whether or not to purchase the limited partnership interest.

App. at 334-36.

Taking the charge as a whole, we conclude that the district court erred in failing to instruct the jurors that projections and opinions may come within the ambit of actionable misrepresentations. There is a sufficient possibility that the jurors would have assumed that the term "existing facts" does not include such projections or opinions that we should overturn the jury verdict in favor of defendants on the securities claim.

Appellees Lieberman and Weinstein justify the district court's action on the ground that clause (2) of plaintiffs' proposed instruction incorrectly stated the requisite standard of culpability. They argue that the requested charge would have permitted the jury to hold the defendants liable if it found that defendants had *any* reason to believe the projections were not reliable, whereas under the proper standard plaintiffs must show that defendants did not have an "informed and reasonable belief" that they were reliable.

In effect, the issue is how to apply the requirements of proof of *scienter* in light of the nature of projections and opinions and the responsibilities of the professionals who ordinarily prepare them. It is insufficient to establish *scienter* to show mere negligent conduct. *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976). However, professionals such as accountants and attorneys who prepare and review opinions for the use of the investing public, and persons who have a special relationship to investors making use of projections, have an affirmative duty to investigate the basis of projections and opinions made and may not simply rely on the opinions or factual submissions of others in reckless disregard of their possible invalidity. *See Marx v. Computer Sciences*

*Corp.*, 507 F.2d at 490. They must also disclose data indicating that the prediction, opinion or recommendation may be doubtful. *See Chris-Craft Industries v. Piper Aircraft Corp.*, 480 F.2d 341, 363-66 (2d Cir.), *cert. denied*, 414 U.S. 910 (1973); Jacobs, *What is a Misleading Statement or Omission under Rule 10b-5 ?*, 42 Fordham L. Rev. at 280-81, 283-84.

The failure of a professional to conduct a sufficient investigation or disclose such data may signify that the opinion has been issued without a reasonable basis and is therefore an "untrue" statement which is culpable conduct actionable under § 10(b) and Rule 10b-5. *Marx v. Computer Sciences Corp.*, 507 F.2d at 490; *Chris-Craft Industries v. Piper Aircraft Corp.*, 480 F.2d at 363-64; Jacobs, *What is a Misleading Statement or Omission under Rule 10b-5?*, 42 Fordham L. Rev. at 280-84. *See Gottreich v. San Francisco Investment Corp.*, 552 F.2d at 867. In contrast, "a reasoned and justified statement of opinion, one with a sound factual or historical basis, is not actionable." *Marx v. Computer Sciences Corp.*, 507 F.2d at 490 (quoting *G & M, Inc. v. Newbern*, 488 F.2d 742, 745-46 (9th Cir. 1973)).

While the formbook instruction proffered by plaintiffs may not have adequately conveyed these subtleties, it was not so seriously erroneous as to justify the district court's failure to give an instruction that predictions and opinions are actionable, which went to the heart of plaintiffs' federal claims.[2]

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2. Because both the negligent misrepresentation claim and the securities claim against Rainess are based on its endorsement of the allegedly fraudulent financial projections, the jury verdict for Rainess on the negligence claims may also have been tainted by the court's failure to instruct as to predictions and opinions. Therefore, we reject Rainess' contention that the unappealed jury verdict in its favor precludes a new trial against it on the securities count.

Rainess mounts a vigorous challenge to the sufficiency of the evidence presented against it, and contends that the instructions, even if erroneous, were harmless as to it since it should have been awarded a directed verdict on the securities claims. The particular assertion by Rainess on which plaintiffs sought to predicate liability was the statement in its opinion that "the assumptions [of management on which the projections of future operations were based] are not unreasonable." One crucial management assumption was that the coal tracts contained 1,250,000 tons each of recoverable coal reserves that could be mined at the rate of 72,000 tons a year. Plaintiffs presented testimony at trial that the offering memoranda overstated reserves by 50% and did not provide sufficient data to support any conclusion as to whether 72,000 tons of coal could be mined a year. Although Rainess claims to have relied on a coal reserve report by an engineer with significant coal experience, J.D. Brackenrich, a jury could find that there were sufficient indicia of unreliability in that report that Rainess should have inquired further and that its failure to do so was in reckless disregard of its duty to assure that there was a reasonable basis for the assumptions. Thus Rainess was not entitled to a directed verdict, and the district court will be directed to grant a new trial for plaintiffs as to all the appellees, including Rainess, assuming the issue remains live after a determination on class certification. *See* Part IV *infra*.

B. *Recklessness*

Appellants also contend that the district court's instruction failed to make clear to the jurors that recklessness could establish liability. The parties agree that a showing of recklessness is sufficient to establish *scienter* for a claim under § 10(b). *See Sharp v.*

*Coopers & Lybrand*, 649 F.2d at 193-94; *Healey v. Catalyst Recovery of Pennsylvania*, 616 F.2d 641, 649 (3d Cir. 1980); *McLean v. Alexander*, 599 F.2d 1190, 1197 (3d Cir. 1979); *Coleco Industries v. Berman*, 567 F.2d 569, 574 (3d Cir. 1977) (per curiam), *cert. denied*, 439 U.S. 830 (1978). The court's instruction on this issue was as follows:

> A "fraudulent misrepresentation" . . . means a representation that an existing fact is true, it being known to the person making said representation that the facts represented to exist do not in fact exist and that said representation is false. A fraudulent misrepresentation may be said to be the intentional misstatement of a person as to the truth of an existing fact, it being then known to the person making said statements that the facts represented to be true are false.
>
> The plaintiff, in order to recover on the 10(b)5 claim, must show that the defendant acted knowingly, that is, with a mental state embracing intent to deceive, manipulate, or defraud . . . [P]laintiff must prove . . . that the defendant stated material facts which he knew to be false, or knew of the existence of material facts which were not disclosed and should have realized their significance in the making of an investment decision. This element may also be established by a showing that the defendant acted with reckless disregard for the truth.

App. at 334-35 (emphasis added).

Since we have held that a new trial is required because of the failure to instruct on projections and opinions, we need not rule whether the above instruction was so inadequate as to be an independent basis for a new trial. However, we take this opportunity

to point out the need for a fuller instruction that defendants are liable if they recklessly expressed opinions which they had good reason to believe were baseless.

III.

*NEGLIGENCE CLAIMS*

The district court had pendent jurisdiction over plaintiffs' claim that defendants had committed the tort of negligent misrepresentation in a business transaction.[3] In *Rempel v. Nationwide Life Ins. Co.*, 471 Pa. 404, 408, 370 A.2d 366, 367-68 (1977), the Pennsylvania Supreme Court accepted the elements of the tort as set forth in the first Restatement of Torts § 552 (1938). The second Restatement is not significantly different in this respect, *cf. Mill-Mar, Inc. v. Statham*, 278 Pa. Super. 296, 299, 420 A.2d 548, 550 (1980) (adopting second Restatement version), *appeal dismissed*, 499 Pa. 219, 452 A.2d 1017 (1982); *Muntan v. City of Monongahela*, 45 Pa. Cmmw. 23, 27, 406 A.2d 811, 813 n.3 (1979) (relying on second Restatement version). It provides in relevant part:

> (1) One who, in the course of his business, profession or employment, or in any other transaction in which he has a pecuniary interest, supplies false information for the guidance of others in their business transactions, is subject to liability *for pecuniary loss caused to them by their justifiable reliance upon the information, if he fails to exercise reasonable care or competence in obtaining or communicating the information.*

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3. Appellants raise no claim contesting the entry of the jury verdict for defendants Rainess, Seidman and Lieberman on the state law negligence count.

> (2) . . . [T]he *liability* stated in Subsection (1) is *limited to loss suffered*
>
> (a) by the person or one of a limited group of persons for whose benefit and guidance he intends to supply the information or knows that the recipient intends to supply it; and
>
> (b) *through reliance upon it in a transaction* that he intends the information to influence or knows that the recipient so intends or in a substantially similar transaction.

Restatement (Second) of Torts § 552 (1977) (emphasis added); *compare* Restatement of Torts § 552 (1938).

A. *Evidence of Reliance*

The district court granted judgment n.o.v. in favor of defendants Wasserstrom and Weinstein on the ground that there was insufficient evidence that plaintiffs had relied upon any misrepresentations. The court stated, "[P]laintiffs' own testimony revealed that not only did they not read the offering memorandum in its entirety, they did not rely upon its contents when they made their investments." App. at 537. Appellants concede that under the Restatement and Pennsylvania law reliance must be shown to establish the tort, but claim the jury was presented with sufficient evidence.

Our review of the record supporting the jury's verdict and the entry of judgment n.o.v. is plenary. In *Danny Kresky Enterprises v. Magid*, 716 F.2d 206, 209 (3d Cir. 1983), we stated:

> A judgment notwithstanding the verdict may be granted under Fed. R. Civ. P. 50(b) "only if, as a matter of law, 'the record is critically deficient of that minimum quantity of evidence from which a jury might reasonably afford relief.'" *Dudley v. South Jersey Metal, Inc.*, 555 F.2d 96, 101 (3d

> Cir. 1977). In considering a motion for judgment n.o.v., the court "must expose the evidence to the strongest light favorable to the party against whom the motion is made and give him the advantage of every fair and reasonable inference." *Inventive Music Ltd. v. Cohen*, 617 F.2d 29, 31 (3d Cir. 1980). On appeal, the appellate court should apply the same standard as the trial court in determining the propriety of a judgment n.o.v. *Harwood & Associates, Inc. v. Texas Bank & Trust*, 654 F.2d 1073, 1076 (5th Cir. 1981).

"[W]e are not free to weigh the evidence, pass on the credibility of the witness, or substitute our judgment of the facts for that of the jury." *Blair v. Manhattan Life Insurance Co.*, 692 F.2d 296, 300 (3d Cir. 1982).

Viewing the verdict and the evidence in the light most favorable to the verdict winner, we conclude that there was sufficient evidence to support a finding of reliance. Plaintiff Nissen testified that he spent an hour or two reading the offering memoranda for the Bar partnership and invested in reliance upon both its possible profitability and tax advantages. Plaintiff Eisenberg's testimony, presented in summarized form by the district court due to Eisenberg's condition of aphasia, was similar. He testified that he had read half of the offering memoranda and skimmed half. Although there was also evidence, including portions of plaintiffs' own testimony, that they had also relied on sources apart from the offering memoranda and that plaintiffs' reading of the documents was less than exacting, plaintiffs' testimony presented sufficient evidence to raise a jury question on the issue of reliance. Plaintiffs need not prove that they read the materials in their entirety, or that the recommendation of an agent or adviser did not play a part in their investment decisions. *See* Restatement (Second) of

Torts § 552(2) & comments g & h. Thus, the district court's grant of judgment n.o.v. on the grounds given was error.

B. *Relevance of an Attorney-Client Relationship*

Wasserstrom argues that we may affirm the district court's entry of judgment n.o.v. on the ground that the jury's verdict against him was, in reality, one for legal malpractice which was not proven because he had no attorney-client relationship with plaintiffs. In Pennsylvania malpractice liability for negligent performance of legal services generally extends only to the lawyer's clients. *Smith v. Griffiths*, 327 Pa. Super. 418, 425-26, 476 A.2d 22, 26 (1984); *but cf. Guy v. Lauderbach*, 501 Pa. 47, 59, 459 A.2d 744, 750 (1983) (rejecting beneficiary's tort claim against attorney who drafted a will but allowing claim that plaintiff was third party beneficiary to contract between lawyer and testator). However, plaintiffs' action in this case was not one for legal malpractice.

Plaintiffs' theory, presented in their amended complaint and in their opening and closing statements, was that Wasserstrom deceived them in a business transaction in which he had a pecuniary interest. Therefore, plaintiffs' verdict does not hinge on the breach of duty an attorney owes clients or others in privity, but rests on the more general principles applicable to a seller or other interested party who misrepresents the nature and value of goods, the tort known generally as negligent misrepresentation.

The Restatement adopted by Pennsylvania and the weight of authority at common law allow an action to be brought by any "person or one of a limited group of persons for whose benefit and guidance he [the maker of the misrepresentation] intends to supply the information or knows that the recipient intends to supply it." Restatement (Second) of Torts § 552(2)(a)

(1977). *See also id.* comment h; W. Keeton, *Prosser & Keeton on the Law of Torts* § 107, at 745-48 (5th ed. 1984). There is no strict privity requirement. The jury had before it sufficient evidence to conclude that Wasserstrom negligently misrepresented the facts underlying the limited partnerships in statements that were specifically intended for the benefit and guidance of a limited class of prospective investors, including plaintiffs. The jury was therefore entitled to conclude that the information was circulated for the specific purpose of inducing members of a particularized class to rely thereupon, a circumstance that would create a duty of due diligence in the maker of the statements and a reasonable expectation of accuracy in the recipients, even without a specific formal relationship between the investors and Wasserstrom. *See Mallis v. Bankers Trust Co.*, 615 F.2d 68, 82-83 (2d Cir. 1980), *cert. denied*, 449 U.S. 1123 (1981). We will therefore reverse the district court's order granting judgment n.o.v. and direct the district court to reinstate the jury's verdict against Wasserstrom and Weinstein.

C. *Wasserstrom's Cross-Appeal for a New Trial*

Wasserstrom's cross-appeal from the district court's denial of his motion for a new trial on plaintiffs' negligence claims challenges the introduction of certain testimony and the damage verdict.[4]

1. Introduction of Monteverde's Testimony

Wasserstrom contends that the district court abused its discretion and committed prejudicial error in allowing Tom Monteverde, Wasserstrom's partner and a principal of the defendant law firm PWC&M, to testify what he believed should have been included in

4. Our preceding discussion disposes of Wasserstrom's challenge to the jury instructions as erroneously stating the elements of legal malpractice, since that was not plaintiffs' claim.

one of the private offering memoranda and as to whether the memorandum complied with the applicable disclosure requirements.

Monteverde is a lawyer specializing in business litigation, who has also acted as general counsel for banks, trucking companies and brokerage houses. Although he had represented clients in securities cases, and testified that he was familiar with the disclosure requirements of federal and state securities laws, he did not view himself as expert in the preparation of offering memoranda.

Monteverde testified that he had looked at one of the offering memoranda when it was being prepared, partly to determine whether a change in applicable tax regulations had been adequately disclosed, and concluded that it had been. Monteverde was then asked whether, based on information learned in connection with the litigation, he believed that the firm and Wasserstrom as draftsman were negligent in not disclosing Wasserstrom's and Chucas' interest in Cannon Coal Company and its parent Seah, and the low purchase price of Cannon several months earlier. Defendants objected that this called for expert testimony. The court ruled the question proper as calling for Monteverde's "professional opinion." Monteverde answered that those facts "should have been set forth in the offering memoranda," App. at 268, and stated, "From my standpoint and a conventional security lawyer's standpoint, that should have been there." App. at 270-71. He further stated that his standards were somewhat higher than those of the average lawyer.

This testimony by Wasserstrom's former partner against his own interests that he had reviewed the disclosure materials and believed them to be adequate, but that he would not have found them adequate had he then had knowledge of additional facts known to his

partners, was not offered as expert testimony under Fed. R. Evid. 703. However, it was not an abuse of discretion for the district court to have admitted it under the lay opinion rule of Fed. R. Evid. 701 which has greatly expanded the realm of opinion testimony by allowing non-experts to give opinions or inferences that are "(a) rationally based on the perception of the witness and (b) helpful to a clear understanding of his testimony or the determination of a fact in issue." Such testimony is admissible even if it "embraces an ultimate issue to be decided by the trier of fact." Fed. R. Evid. 704. We have recognized that the "modern trend favors the admission of opinion testimony, provided that it is well founded on personal knowledge and susceptible to specific cross-examination." *Teen-Ed, Inc. v. Kimball International, Inc.*, 620 F.2d 399, 403 (3d Cir. 1980).

A number of recent decisions have recognized that some lay witnesses are qualified to give a conclusion based on personal experience with documentary or physical materials. *See, e.g., Soden v. Freightliner Corp.*, 714 F.2d 498, 510-12 (5th Cir. 1983) (service manager in charge of maintenance of trucks allowed to give opinion as to defect and its dangerousness); *Joy Manufacturing Co. v. Sola Basic Industries*, 697 F.2d 104, 110-12 (3d Cir. 1982) (worker allowed to testify as to proportion of downtime due to hearth problems); *United States v. Grote*, 632 F.2d 387, 390 (5th Cir. 1980), *cert. denied*, 454 U.S. 819 (1981) (IRS agent could give opinion as to whether tax returns filed were acceptable or not); *Teen-Ed v. Kimball International*, 620 F.2d at 403-04 (accountant familiar with books could give lay opinion as to how lost profits should be calculated). *See also United States v. Ranney*, 719 F.2d 1183, 1189 n.11 (1st Cir. 1983) (investors in heating oil futures could give lay opinion based on their personal knowledge about the value of the investment opportunity offered by defendants).

Since Monteverde personally observed the preparation of the offering memoranda and scrutinized them for adequacy of disclosure, and possessed the qualifications to draw legal conclusions from them, his testimony as to how he would have viewed the undisclosed facts was not an impermissible answer to a hypothetical question by a non-expert, but remained a lay inference from his prior personal experience and observation.

Monteverde was also asked and testified, without objection, that the offering memoranda were "not in compliance with what [he] regarded as the disclosure obligations that existed in 1976." App. at 271. In light of defendants' failure to object to this specific question as impermissible, we need not decide whether this, as distinguished from Monteverde's other testimony, exceeded the bounds of permissible inquiry of a lay witness.[5]

2. Damages

Wasserstrom also contends that the jury's award cannot be sustained because it conflicts with the instructions given. Our standard of review is whether the district court abused its discretion in denying Wasserstrom's motion for a new trial.

The narrative facts on damages were undisputed. Eisenberg and Nissen invested, respectively, $12,500 and $15,000 in cash, and signed non-recourse notes in addition, all of which ultimately provided no return. On their tax returns for the year 1976 they claimed, as a result, deductions of, respectively, $43,396 and $52,077. These deductions translated into net tax

5. Moreover, although Monteverde's testimony was not technically an admission, many of the policies that allow the evidence of a party's admission would also apply here. Because we believe that Fed. R. Evid. 701 is broad enough to encompass Monteverde's testimony, we do not explore this other potential basis to support the district court's ruling.

savings of, respectively, $17,605 and $22,677. The IRS denied plaintiffs' deductions based on the non-recourse notes. Under a 1982 settlement with the IRS, plaintiffs were to pay back taxes and interest for the disallowed deductions, but were allowed to deduct as an ordinary investment loss the cash sums invested in the coal mining partnerships. Eisenberg paid the IRS $13,908 in back taxes and $7,339 in interest, or $21,247 total. Nissen paid the IRS $16,396 in back taxes and $8,446 in interest, or $24,044 total. Both plaintiffs deducted these interest payments from their 1982 taxes, and both were, at all relevant times, in the 50 percent tax bracket.

Plaintiffs did not seek recovery of the back taxes they paid the IRS, but sought only the value of their investments and the interest they had to pay the IRS in 1982 as a result of the disallowance of their claimed deductions. Defendants apparently conceded that these were recoverable losses but argued to the jury that plaintiffs had received tax benefits that completely offset these losses in that plaintiffs had the use of tax savings between 1977 (when they claimed the tax shelter write-off) and 1982 (when the IRS allowed the deduction and they reached a settlement), and deducted the actual losses and back interest paid to the IRS.

The charge, apparently favorable to defendants, was general and simple. The court instructed the jury to award the "actual loss" suffered as a result of defendants' negligence, "tak[ing] into account any tax benefits the plaintiffs received from their investment, but that is for you, ladies and gentlemen, to so determine." Tr. Feb. 24, 1984 at 83. The court further explained that the jury was to compensate plaintiffs for "actual pecuniary loss", including (1) the difference between the amount paid and the real value of what they received and (2) "all other pecuniary loss suffered

as a consequence of the negligence, including the additional expenses and losses incurred as a result of the negligence, but not including the profit the plaintiff . . . has made." *Id.* at 84.

The jury awarded Eisenberg $18,300 and Nissen $23,000 in a general verdict. The parties agree on the interpretation of this verdict that the jury awarded approximately the total sum invested plus the interest plaintiffs paid to the IRS, without substantial deductions for tax benefits. Wasserstrom frames the issue before us narrowly. He apparently concedes that the jury could have concluded that there was no cognizable tax benefit to plaintiffs from the use of the tax savings between 1977 and 1982. He argues only that the jury must have disregarded the court's instructions in failing to reduce the award by 50 percent because the ultimate loss on the investment and the interest paid were deductible.

There are two obstacles to Wasserstrom's contention. First, defendants clearly were willing to present the tax benefit issue as a jury question and allow the jury to decide whether, on the facts, there was any tax benefit. Second, the jury's determination was consistent with Pennsylvania law regarding the tax consequences of injuries from negligence.

The Pennsylvania Supreme Court has broadly held that, "[i]ncome tax as it relates to damages should be mentioned neither in argument nor in jury instructions." *Gradel v. Inouye*, 491 Pa. 534, 547, 421 A.2d 674, 680 (1980). *See also Girard Trust Corn Exchange Bank v. Philadelphia Transportation Co.*, 410 Pa. 530, 538, 190 A.2d 293, 298 (1963). This holding has been applied both to bar references to the nontaxability of a personal injury damage award, *see, e.g., Logan v. Stelmach*, 325 Pa. Super. 181, 184-85, 472 A.2d 708, 709-10 (1984), and to bar consideration of the taxes on lost income that an accident victim

would have paid, *Richardson v. LaBuz*, 81 Pa. Cmmw. 436, 474 A.2d 1181, 1196-97 (1984). It follows that Pennsylvania would not permit a jury to consider the taxability of the award to plaintiffs nor the deductibility of the loss prior to the award in assessing damages,[6] and that the district court did not err in denying Wasserstrom's motion for a new trial.

D. *Respondeat Superior Liability of PWC&M*

Plaintiffs moved for a directed verdict and then judgment n.o.v. against the defendant law firm of PWC&M on the ground that the jury had before it no evidence on which the firm could escape respondeat superior liability for the acts of attorney Wasserstrom. The jury instruction was as follows:

> The law . . . holds a corporation responsible for all unlawful acts of its directors, or officers, or employees, or other agents, provided such unlawful acts are done within the scope of their authority, as would usually be the case if done in the ordinary course of their employment, or in the ordinary course of the corporation's business.
>
> Authority to act for a corporation in a particular matter, or in a particular way or manner, may be inferred from the surrounding facts and circumstances shown by the evidence in the case . . . .

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6. This appeal does not present the more difficult issue of whether a tax benefit in excess of the actual investment loss, such as is commonly anticipated in tax shelter investments, would be taken into consideration in Pennsylvania as part of the measure of actual loss. We note that courts appear divided on this issue when it has arisen under federal securities law. *Compare* William Z. Salcer v. Envicon Equities Corp., 744 F.2d 935 (2d Cir. 1984) and Austin v. Loftsgaarden, 675 F.2d 168, 180-84 (8th Cir. 1982) *with* Burgess v. Premier Corp., 727 F.2d 826, 837-38 (9th Cir. 1984).

> Every act of every director, or officer, or employee, or other agent, on behalf of, or in the name of a corporation, if done within the scope of his authority, is in law the act of the corporation itself.

App. at 344-45. It is irrelevant for our purposes that plaintiffs failed to object to this instruction, since plaintiffs seek judgment n.o.v. on the basis of the evidence presented.

It was undisputed at trial that Wasserstrom was an employee-shareholder of the professional corporation and acted as would a partner in law firms organized as partnerships; that PWC&M received a $25,000 fee for Wasserstrom's services in preparing each of the offering memoranda; that the tax opinion Wasserstrom drafted was issued in the name of the firm PWC&M and had, in fact, been reviewed by Monteverde, one of the principals of the law firm; and that Wasserstrom was acting in his capacity as an employee of PWC&M in preparing the offering materials. Moreover, there was unrebutted testimony by Monteverde that the offering materials would have been more carefully scrutinized by other lawyers of the firm had the press of business not interfered. We believe that this evidence requires a finding that, as a matter of law, Wasserstrom's preparation of the offering materials and related activities were within the scope of his employment and that the firm should be held vicariously liable.

Even if the jury focused on Wasserstrom's personal interest in the transactions, Pennsylvania law is clear that the mere existence of a personal motivation is insufficient to shield a principal from liability where the conduct was also to the benefit of and within the scope of employment generally. *See Yaindl v. Ingersoll-Rand Co.*, 281 Pa. Super. 560, 575-76, 422 A.2d 611, 619 (1981); Restatement (Second) of Agency § 236 (1958). On these facts, we believe that no

reasonable jury could conclude that Wasserstrom was acting outside the scope of his employment and authority when he prepared the offering materials for the limited partnerships.[7]

There are two potentially applicable lines of Pennsylvania cases, one holding that negligent and even fraudulent misrepresentations by an employee may give rise to respondeat superior liability of the employer, *see Rempel v. Nationwide Life Insurance Co.*, 471 Pa. 404, 370 A.2d 366 (1977); *First National Bank of Altoona v. Turchetta*, 407 Pa. 511, 181 A.2d 285, 287-88 (1962); *Muntan v. City of Monongahela*, 45 Pa. Cmmw. 23, 27-28, 406 A.2d 811, 813-14 (1979); *see also Sharp v. Coopers & Lybrand*, 649 F.2d 175, 184 (3d Cir.) (dictum), *cert. denied*, 455 U.S. 938 (1981); *Bowman v. Home Life Insurance Co. of America*, 243 F.2d 331, 335 (3d Cir. 1957) (construing Pennsylvania law), and the other holding that a principal may not be liable for an action in fraud and deceit for an agent's false representations absent proof of authorization or participation by the principal. *See Eckrich v. DiNardo*, 283 Pa. Super. 84, 90, 423 A.2d 727, 729-30 (1980); *Shane v. Hoffmann*, 227 Pa. Super. 176, 183-84, 324 A.2d 532, 537 (1974). *See also Littler v. Dunbar*, 166 Pa. Super. 271, 273-74, 70 A.2d 365, 366, *rev'd on other grounds*, 365 Pa. 277, 74 A.2d 650 (1950) (approving reasoning on this point); *Aiello v. Ed Saxe Real Estate, Inc.*, Pa. Super. , 476 A.2d 27, 30-32 (1984). We need not attempt a complete reconciliation of Pennsylvania authority. It is sufficient for our purposes to note that underlying many of the cases in this field are two distinctions: one, between an employee and an agent not subject to

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7. The extent of respondeat superior liability under the federal securities laws, *see e.g.*, Sharp v. Coopers & Lybrand, 649 F.2d 175, 180-85 (3d Cir. 1981); Rochez Brothers, Inc. v. Rhoads, 527 F.2d 880, 884-86 (3d Cir. 1975), *cert. denied*, 425 U.S. 993 (1976) is not before us.

control by the employer, and another between intentional and unintentional torts of the agent. *See generally* W. Keeton, *Prosser and Keeton on the Law of Torts* § 70, at 505-06, 508 (5th ed. 1984). Although the above cases may be read to hold that an uncontrolled *agent* who *fraudulently* misrepresents facts does not cause vicarious liability to the principal, we predict that the Pennsylvania Supreme Court would not exonerate from vicarious liability a firm whose *employee* was simply *negligent* in preparing materials and whose work was in fact subject to the review and control of the firm.

This reading is consistent with the language of the Pennsylvania statute governing liability of professional corporations, which states:

> The professional corporation shall be liable up to the full value of its property for any negligent or wrongful acts or misconduct committed by any of its officers, shareholders, employees or agents while they are engaged on behalf of the corporation in rendering professional services.

15 Pa. Stat. Ann. § 2913(b) (Purdon Supp. 1984-85).

We conclude that PWC&M was vicariously liable for the acts of shareholder-employee and "de-facto partner" Wasserstrom in negligently preparing offering materials during the scope of his employment with the firm and for the firm's benefit, and that the jury's verdict in favor of the firm must be overturned as unsupported by the evidence. We will direct the district court to enter judgment against PWC&M on this count.

## IV.

## *DENIAL OF CLASS CERTIFICATION*

Appellants contend that the district court abused its discretion in denying certification of a class action in this case. At the outset, we reject Wasserstrom's contention that the issue is moot because the jury

rejected plaintiffs' securities claims. In the first place, we are sending that claim back for a new determination by the jury. In the second place, the jury did find some of the defendants culpable on the tort claim, as to which class certification was also sought. Finally, in *United States Parole Commission v. Geraghty*, 445 U.S. 388 (1980), the Court held that even the expiration of a named plaintiff's substantive claim does not render moot the action brought on behalf of the class. We have applied *Geraghty* in concluding that the defeat of the named plaintiff's individual claim on the merits, after denial of class certification, does not moot the class action issues. *See Mazus v. Department of Transportation*, 629 F.2d 870, 875-76 (3d Cir. 1980), *cert. denied*, 449 U.S. 1126 (1981); *Alexander v. Gino's, Inc.*, 621 F.2d 71, 73-74 (3d Cir.) (per curiam), *cert. denied*, 449 U.S. 953 (1980).

Similarly, we can perceive no bar to the present appeal because the named plaintiffs have won relief on the merits. Indeed, in holding that denial of class certification was not an appealable collateral order, the Court made clear that the individual plaintiff retained "the prospect of prevailing on the merits and reversing an order denying class certification". *Coopers & Lybrand v. Livesay*, 437 U.S. 463, 469, 470 n.15 (1978). In *Geraghty*, it reaffirmed "that the proposed class representative who proceeds to a judgment on the merits may appeal *denial* of class certification." 445 U.S. at 399 (emphasis in original). *See also Deposit Guaranty National Bank v. Roper*, 445 U.S. 326 (1980). At a minimum, the named plaintiffs would have an interest in pursuing the class action "in their desire to shift part of the costs of litigation to those who will share in its benefits if the class is certified and ultimately prevails." *Id.* at 336. We turn, therefore, to decide whether the district court abused its discretion in denying class certification.

Plaintiffs sought certification as class representatives of "all persons who purchased limited partnership securities in Ark, Bar or Cay, with the exception of the defendants herein and any entity controlled by any of the defendants herein." Their complaint alleged that this group totalled at least 93 persons; that plaintiffs were class members with claims typical of those of the class and without conflicting interests; that the case presented predominating common issues of law and fact as to defendants' offering of the partnerships; and that a class action would be a superior method to adjudicate the controversy.

Defendants opposed maintenance of the class action on a variety of grounds, including that Eisenberg and Nissen were inadequate class representatives and that the claims asserted presented individual, rather than common, issues. The district court denied certification with a terse order that stated only, "The plaintiffs seeking to represent the proposed class have failed to satisfy the court that their claims are typical of the claims of the proposed class." Fed. R. Civ. P. 23(a)(3) provides that a class action may be maintained only if "the claims or defenses of the representative parties are typical of the claims or defenses of the class." The court thereafter denied plaintiffs' motion for renewed consideration of class certification, reaffirming the prior order without explanation.

The district court should have further amplified its reasoning. Although the Federal Rules do not mandate findings of fact and conclusions of law for rulings on motions to certify a class, we have stated that,

> [W]here, as here, the district court is presented with conflicting positions of substance as to how it should exercise its discretion in determining whether to permit a class action, it is a salutary practice to give the litigants, either orally or in

> writing, at least a minimum articulation of the reasons for its decision. This is particularly true because of the practical importance of such a determination and the limited possibility of obtaining a seasonable review of the determination.

*Interpace Corp. v. City of Philadelphia*, 438 F.2d 401, 404 (3d Cir. 1971). Articulation by the district court of the factors considered and the weight accorded to them in making a discretionary ruling is more likely to convince the reviewing court that the ruling was consistent with the sound exercise of discretion, *see United States v. Criden*, 648 F.2d 814, 819 (3d Cir. 1981), a conclusion we cannot reach under the circumstances here.

Class actions are a particularly appropriate and desirable means to resolve claims based on the securities laws, "since the effectiveness of the securities laws may depend in large measure on the application of the class action device." *Kahan v. Rosenstiel*, 424 F.2d 161, 169 (3d Cir.), *cert. denied*, 398 U.S. 950 (1970). We stated further, "[T]he interests of justice require that in a doubtful case . . . any error, if there is to be one, should be committed in favor of allowing a class action." *Id.* (quoting *Esplin v. Hirschi*, 402 F.2d 94, 101 (10th Cir. 1968), *cert. denied*, 394 U.S. 928 (1969)). As the Second Circuit has noted, "a class action [in a federal securities action] may well be the appropriate means for expeditious litigation of the issues, because a large number of individuals may have been injured, although no one person may have been damaged to a degree which would have induced him to institute litigation solely on his own behalf." *Green v. Wolf Corp.*, 406 F.2d 291, 296 (2d Cir. 19[illegible], *cert. denied*, 395 U.S. 977 (1969).

The complaint here adequately alleged the existence of a class of investors similarly situated to

Eisenberg and Nissen. The allegation of more than 90 geographically dispersed plaintiffs met the numerosity requirement of Fed. R. Civ. P. 23(a)(1). Plaintiffs presented a sufficient number of common questions of law and fact to meet the requirements of Rule 23(a)(2), in particular the defendants' liability for the alleged omissions and misrepresentations common to the offering and sale of all three limited partnerships. Although the three partnerships had different general partners, it would be possible, if necessary, to determine at the damages stage which general partner is liable to which investors.

The presence of individual questions as to the reliance of each investor does not mean that the common questions of law and fact do not predominate over questions affecting individual members as required by Rule 23(b)(3) or that the representative's claims are not typical. In rejecting such a contention, the Second Circuit stated, "Carried to its logical end [this argument] would negate any attempted class action under Rule 10b-5, since as the District Courts have recognized, reliance is an issue lurking in every 10b-5 action." *Green v. Wolf Corp.*, 406 F.2d at 301. Rather than eliminate securities class actions, it would be more efficient to order separate trials, if necessary, limited to the issue of reliance. A well-reasoned opinion by then Chief Judge Lord of the Eastern District of Pennsylvania reaches the same conclusion. *Sharp v. Coopers & Lybrand*, 70 F.R.D. 544, 547-48 (E.D. Pa. 1976). *Accord Entin v. Barg*, 60 F.R.D. 108, 112-13 (E.D. Pa. 1973); *In Re Penn Central Securities Litigation*, 347 F. Supp. 1327, 1344-45 (E.D. Pa. 1972), *aff'd*, 494 F.2d 528 (3d Cir. 1974). *See generally* 1 *Newberg on Class Actions* § 1115c (1977); 3B *Moore's Federal Practice* ¶ 23.46 at 406-411 (1985), and cases cited therein.

The typicality requirement of Rule 23(a)(3), on which the district court specifically relied to deny class

treatment, is something of an enigma in the jurisprudence of class actions. To a large extent, it overlaps the requirements that the named representatives adequately represent the class, that there be common questions of law and fact, that such questions predominate, and that the class action be a superior means of resolution. *See* H. Newberg, 1 *Newberg on Class Actions*, § 1115a (1977); 3B *Moore's Federal Practice* ¶ 23.06-2 (1985). Nevertheless, Rule 23(a)(3) requiring typicality permits the court to assess whether the class representatives themselves present those common issues of law and fact that justify class treatment, thereby tending to assure that the absent class members will be adequately represented. *See id.* at 191-92. "Typical" is not identical, however, *id.* at 197 (1984-85 Supp.), and even atypical elements of a claim may often be adequately treated by judicious severance or use of subclasses or other separate treatment of individual issues. *See Green v. Wolf Corp.*, 406 F.2d at 299; *Sharp v. Coopers & Lybrand*, 70 F.R.D. at 548-49. As we recently suggested, typicality entails an inquiry whether "the named plaintiff's individual circumstances are markedly different or . . . the legal theory upon which the claims are based differs from that upon which the claims of other class members will perforce be based." *Weiss v. York Hospital*, 745 F.2d 786, 809 n.36 (3d Cir. 1984), *cert. denied*, 105 S. Ct. 1777 (1985).

Eisenberg and Nissen were not untypical because they invested in two different limited partnerships or because members of the class may have invested in either of these two, or in a third. Plaintiffs' case was that these were identical investments, prepared by the same defendants, and containing the same alleged omissions and misrepresentations.

Assuming that the district court's order may have turned on the existence of individual issues as to

reliance, we believe it was an abuse of discretion not to certify the class on that ground. This case did not present extraordinarily complex questions of causation and reliance, despite the possibility that only some members of the class may have relied on the offering materials prepared by defendants in choosing to invest. Nor was this case one founded on a variety of oral representations, a circumstance which might present a greater obstacle to class treatment, since the core of this case is the claim that the named plaintiffs, and presumably the class members, relied on virtually identical written materials. *See Sharp v. Coopers & Lybrand*, 70 F.R.D. at 548; *see also Kennedy v. Tallant*, 710 F.2d 711, 717-18 (11th Cir. 1983). Thus it is not, as Wasserstrom suggests, analogous to a "mass tort" case, in which individual causation issues might prove a more significant obstacle. We conclude, therefore, that it was an abuse of discretion to deny class certification on the ground that Eisenberg's and Nissen's claims were atypical.

Eisenberg and Nissen ask us to direct the district court to certify the class. There are several reasons why such an order would be inappropriate. First, we find it difficult to evaluate, on the cold record, several of the remaining prerequisites to a 23(b)(3) class action, which the district court did not address. For example, defendants Weinstein and Lieberman assert that Eisenberg would be an inadequate representative under Rule 23(a)(4), given his aphasia, which prevented him from being deposed or from testifying before the jury at trial. This issue is best addressed in the first instance by the district court.

Second, class actions depend on the continuing supervision of the district court, including reconsideration of the efficacy of class action treatment as the circumstances change. One circumstance that has clearly changed is that Eisenberg and Nissen have

now won a judgment on the merits. The Supreme Court was careful to point out in *Geraghty* that, although the class action issue was not moot, the adequacy of the representative would still have to be determined because it is not automatically established "that the named plaintiff is entitled to continue litigating the interests of the class." 455 U.S. at 405.

Therefore, we will leave the issue of class certification to the district court on remand subject, however, to our decision that the record as established demonstrates that common questions of law and fact predominate and that, as of the order denying certification, the named representatives' claims were typical of those of the class.

If, on remand, the district court denies certification, that court will have to address whether the named plaintiffs' claims on the federal securities issue are moot since they may not be seeking any further relief beyond the negligence judgments we have reinstated.

## V.

## *REMAINING ISSUES*

We have considered each of the remaining issues raised by the parties, and have rejected all contentions not specifically discussed herein. Since the securities claim may be retried, we believe it may be useful to rule on appellants' contention that the district court should have compelled production of correspondence between Monteverde, a principal of defendant firm PWC&M, and counsel for the firm's insurer, Michael Gallagher.

PWC&M's insurer had arranged for PWC&M to be represented by Daniel Ryan, for Wasserstrom to be represented by Edward Mengel, and for its own interests as well as the coordination of the defense effort to be represented by Michael Gallagher, all of different law firms. Although the interests of these

parties largely coincided, there was some correspondence between Monteverde and Gallagher regarding Monteverde's position that information known to Wasserstrom should have been disclosed to investors and the trial strategy that PWC&M should adopt in connection therewith.

We agree with the district court's ruling that the correspondence was privileged, since it is best viewed as part of an ongoing and joint effort to set up a common defense strategy between a defendant and an attorney who was responsible for coordinating a common defense position. Communications to an attorney to establish a common defense strategy are privileged even though the attorney represents another client with some adverse interests. *See United States v. McPartlin*, 595 F.2d 1321, 1336-37 (7th Cir.), *cert. denied*, 444 U.S. 833 (1979); *Hunydee v. United States*, 355 F.2d 183, 184-85 (9th Cir. 1965); *Continental Oil Co. v. United States*, 330 F.2d 347, 349-50 (9th Cir. 1964); 2 J. Weinstein & M. Berger, *Weinstein's Evidence* ¶ 503(b)[06] (1982). *See also Id.* ¶ 503(b)[07] at 503-65.

This situation is not governed by those cases holding there is no privilege for communications with another's attorney where the parties interests are completely adverse and it is clear that the statements were not made in the expectation that the relationship was confidential. *See Government of the Virgin Islands v. Joseph*, 685 F.2d 857, 862 (3d Cir. 1982); *United States v. Cariello*, 536 F. Supp. 698, 702 (D.N.J. 1982). Nor do we believe that the privilege was waived when Monteverde's discussion of the correspondence at sidebar, made in the expectation that it was *in camera*, came into the hands of plaintiffs' counsel despite the request of defense counsel that the sidebar conference be sealed. "No matter what standard of waiver [of privilege] is applied,

the waiver must be knowing." *In the Matter of Grand Jury Empanelled October 18, 1979 (Appeal of Malfitano)*, 633 F.2d 276, 280 (3d Cir. 1980). The district court neither erred nor abused its discretion in denying plaintiffs' motion to compel discovery of this correspondence.

VI.

*CONCLUSION*

For the reasons set forth above we will vacate the judgments in favor of all appellees on the securities count because the instructions were erroneous on fraudulent projections; we will reverse the order directing judgment n.o.v. for Wasserstrom and Weinstein on the common-law negligence count and direct the court to reinstate the jury verdict; we will reverse the order denying plaintiffs' motion for judgment n.o.v. against the law firm PWC&M on respondeat superior grounds and will direct the court to enter judgment for plaintiffs against PWC&M on that count; we will affirm the court's denial of Wasserstrom's motion, presented here on cross-appeal, for a new trial on both the merits and on damages; and we will vacate the court's order denying class certification and remand for further proceedings.

Costs are to be assessed against appellees who are to attempt to divide them amicably among themselves.

A True Copy:

Teste:

*Clerk of the United States Court of Appeals*
*for the Third Circuit*

(A.O. U.S. Courts. G.M.C. Printing, Phila., Pa. 215-568-4264)

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

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Nos. 84-1214, 84-1225, 84-1261

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MARTIN EISENBERG and ARTHUR NISSEN,
on behalf of themselves and all
others similarly situated

v.

FREDERICK M. GAGNON, BERNARD A.
BOYERS, DAVID E. WASSERSTROM,
CHARLES LIEBERMAN, EDWARD
HERSHENHORN, DAVID WEINSTEIN,
JOHN W. PELINO, MORRIS L.
CHUCAS, TOM P. MONTEVERDE,
WASSERSTROM & CHUCAS, and
PELINO, WASSERSTROM,
CHUCAS & MONTEVERDE, P.C.

v.

GELROD, FOX and CO., CLARENCE
RAINESS & CO., SEIDMAN and
SEIDMAN, GRUNTAL and CO.,
MARVIN WELSCH and JACK PANICH,

MARTIN EISENBERG AND ARTHUR NISSEN,
*Appellants*
in Nos. 84-1214 &
84-1225

DAVID E. WASSERSTROM,
*Cross-Appellant*
in No. 84-1261

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On Appeal from the United States District
Court for the Eastern District
of Pennsylvania
(D.C. Civil No. 82-5051)

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Before: SEITZ, GIBBONS and SLOVITER,
*Circuit Judges*

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**ORDER AMENDING OPINION**

It is ORDERED that the slip opinion of this court filed June 28, 1985 be amended as follows:

Substitute the following for the material in the slip opinion beginning with the first full paragraph on page 10 and concluding with the words "*See* Part IV *infra*" at the end of the first paragraph on page 12:

> There is a possibility that taking the charge as a whole the jurors would have assumed that the term "existing facts" does not include projections or opinions. This would have been a serious error of law. An opinion or projection, like any other representation, will be untrue if it has no valid basis, *see Marx v. Computer Sciences Corp.*, 507 F.2d at 490, but "a reasoned and justified statement of opinion, one with a sound factual or historical basis, is not actionable." *Id.* (quoting *G & M, Inc. v. Newbern*, 488 F.2d 742, 745-46 (9th Cir. 1973)). Since the district court's error in failing to instruct the jurors that projections and opinions come within the ambit of actionable misrepresentations may have affected the jurors' verdict as to all of the defendants,

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we must overturn the jury verdict in favor of defendants on the securities claim.[2]

Appellees Lieberman and Weinstein justify the district court's failure to instruct the jurors on projections and opinions on the ground that plaintiffs' proposed instruction incorrectly stated the requisite standard of culpability. They argue that the requested charge would have permitted the jury to hold the defendants liable if it found that defendants had *any* reason to believe the projections were not reliable, whereas under the proper standard plaintiffs must show that defendants did not have an "informed and reasonable belief" that they were reliable. While the formbook instruction proffered by plaintiffs may not have adequately conveyed all the subtleties involved when the alleged misrepresentation stems from a projection or opinion, it was not so seriously erroneous as to justify the district court's failure to give an instruction that predictions and opinions are actionable, which went to the heart of plaintiffs' federal claims.

In establishing *scienter* with respect to projections and opinions, it is insufficient to show mere negligent conduct, *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976), or that a forecast turned out to be inaccurate. However, as this court has previously stated, an opinion must not be made "with reckless

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2. Because both the negligent misrepresentation claim and the securities claim against Raines are based on its endorsement of the allegedly fraudulent financial projections, the jury verdict for Raines on the negligence claims may also have been tainted by the court's failure to instruct as to predictions and opinions. Therefore, we reject Raines' contention that the unappealed jury verdict in its favor precludes a new trial against it on the securities count.

disregard for its truth or falsity," or with a lack of a "genuine belief that the information disclosed was accurate and complete in all material respects." *McLean v. Alexander*, 599 F.2d 1190, 1198 (3d Cir. 1979) (quoting *Ultramares v. Touche*, 255 N.Y. 170, 174 N.E. 441 (1931) (Cardozo, J.)). Therefore, an opinion that has been issued without a genuine belief or reasonable basis is an "untrue" statement which, if made knowingly or recklessly, is culpable conduct actionable under § 10(b) and Rule 10b-5. *See Marx v. Computer Sciences Corp.*, 507 F.2d at 490; *Chris-Craft Industries v. Piper Aircraft Corp.*, 480 F.2d at 341, 363-64 (2d Cir.), *cert. denied*, 414 U.S. 910 (1973); Jacobs, *What is a Misleading Statement or Omission under Rule 10b-5?*, 42 Fordham L. Rev. at 280-84. *See also Gottreich v. San Francisco Investment Corp.*, 552 F.2d at 867.

When a representation is made by professionals or "those with greater access to information or having a special relationship to investors making use of the information," there is an obligation to disclose data indicating that the opinion or forecast may be doubtful. *See Chris-Craft Industries v. Piper Aircraft Corp.*, 480 F.2d at 363-66; Jacobs, *What is a Misleading Statement or Omission under Rule 10b-5?*, 42 Fordham L. Rev. at 280-81, 283-84. When the opinion or forecast is based on underlying materials which on their face or under the circumstances suggest that they cannot be relied on without further inquiry, then the failure to investigate further may "support[] an inference that when [the defendant] expressed the opinion it had no genuine belief that it had the information on which it could predicate that opinion." *McLean v. Alexander*, 599 F.2d at 1198.

Rainess mounts a vigorous challenge to the sufficiency of the evidence presented against it, and

contends that the instructions, even if erroneous, were harmless as to it since it should have been awarded a directed verdict on the securities claims. The particular assertion by Rainess on which plaintiffs sought to predicate liability was the statement in its opinion that "the assumptions [of management on which the projections of future operations were based] are not unreasonable." One crucial management assumption was that the coal tracts contained 1,250,000 tons each of recoverable coal reserves that could be mined at the rate of 72,000 tons a year. Plaintiffs presented testimony at trial that the offering memoranda overstated reserves by 50% and did not provide sufficient data to support any conclusion as to whether 72,000 tons of coal could be mined a year. Although Rainess claims to have relied on a coal reserve report by J.D. Brackenrich, an engineer with significant coal experience, and Lieberman and Weinstein also contend that this report gave all defendants a reasonable basis for the projections, a jury could find that there were sufficient indicia of unreliability in that report that Rainess, and possibly other defendants, should have inquired further and that the failure to do so was in reckless disregard of the duty to assure that there was a reasonable basis for the assumptions.

The report itself, which was addressed to Gagnon, stated that it was only an estimate based on visual inspection and that core-drilling and surface prospecting should be done. Nothing in the report suggested that it would or should be used for estimates in a securities prospectus. In fact, the engineer who prepared the report testified that the report had been altered to increase the stated coal reserves without his authorization after he prepared it. Harry Epstein, an accountant with defendant

Rainess, admitted that he noted that the typeface changed in the middle of the engineer's report, but that he made no inquiry about that. In fact, there was no evidence that Rainess made any effort at independent investigation of the accuracy of the report, in contrast to the efforts at confirmation made by the accounting firm that was a defendant in *McLean v. Alexander*, 599 F.2d at 1199-1202. Thus, we reject Rainess' argument that it was entitled to a directed verdict.

As stated above, the district court will be directed to grant a new trial for plaintiffs as to all the appellees, including Rainess, assuming the issue remains live after a determination on class certification. *See* Part IV *infra*. At the new trial, the issue of whether the circumstances generated a similar duty to investigate on the part of each of the defendants will be for determination by the jury, guided by the court's instructions in light of the evidence presented.

By the Court,

Dated: July 26, 1985

Dolores K. Sloviter
Circuit Judge

A True Copy:

Teste:

*Clerk of the United States Court of Appeals*
*for the Third Circuit*

**IN THE UNITED STATES DISTRICT COURT**
**FOR THE EASTERN DISTRICT OF PENNSYLVANIA**

| | | |
|---|---|---|
| MARTIN EISENBERG and ARTHUR NISSEN, on behalf of themselves and all others similarly situated | : | |
| *vs.* | : | C.A. NO. 82-5051 |
| FREDERICK M. GAGNON, et al | : | |

**MEMORANDUM OPINION AND ORDER**

WEINER, *J.* MARCH 30, 1984

This action was tried before this court, sitting with a jury, which resulted in verdicts in favor of plaintiff Martin Eisenberg against defendant David Wasserstrom in the sum of $12,200.00 and against defendant David Weinstein in the amount of $6,100.00, and in favor of plaintiff Arthur Nissen against defendant David Wasserstrom in the amount of $23,000.00. Presently before the court are the motions of defendant David Wasserstrom and of defendant David Weinstein for judgment n.o.v., and/or remittur, and/or new trial on damages. For the reasons which follow we grant the motions of the defendants for judgment n.o.v.

In deciding the motions of the defendants for a judgment notwithstanding the verdict, this court must determine whether, as a matter of law, a verdict should have been directed for the defendants at the end of the trial. *Neville Chemical Co. v. Union Carbide Corp.*, 422 F.2d 1205, 1210 (3d Cir. 1970), *Marks v. Mobil Oil Corp.*, 562 F.Supp. 759, 764 (E.D. Pa. 1983).

The threshold question is whether after giving the verdict winner the benefit of all reasonable inferences capable of being drawn from the evidence, we conclude as a matter of law that the record lacked the minimum

amount of evidence from which a jury could have reached its verdict. *Blair v. Manhattan Life Ins. Co.*, 692 F.2d 296, 300 (3d Cir. 1982).

Rule 50(b) of the Federal Rules of Civil Procedure provides that whenever a motion for directed verdict made at the close of all evidence is denied, the court is deemed to have submitted the action to the jury subject to a later determination of the legal questions raised by the motion. *Fed. Proc., L. Ed*, §62:692. In the case *sub judice*, the defendants made timely motions for directed verdict which were denied.

To grant a motion for judgment n.o.v. we must find as a matter of law that the facts adduced at trial fail to justify the verdict. *See, Woodward and Dickerson, Inc. v. Yoo Hoo Beverage Co.*, 502 F.Supp. 395, 397 (E. D. Pa. 1980). "Such a motion 'may be granted only when, without weighing the credibility of the evidence, there can be but one reasonable conclusion as to the proper judgment.' " *Id.*, quoting 5A Moore's Federal Practice §50.07[2], at 50-77. The jury's verdict may be set aside only if manifest injustice will result if it were allowed to stand. *Lind v. Schenley Industries, Inc.*, 278 F.2d 79, 89 (3d Cir.), *cert. denied*, 364 U.S. 835 (1960). In considering the motion, we must view the evidence in the light most favorable to the party against whom the motion is made and give him the advantage of every fair and reasonable inference. *Fireman's Fund Ins. Co. v. Videfreeze Corp.*, 540 F.2d 1171, 1178 (3d Cir. 1976); 5A Moore's Federal Practice §50.07[2].

Plaintiffs' theory was that the private offering memoranda prepared by defendant Wasserstrom negligently misrepresented material facts, failed to disclose material facts, and that both plaintiffs read and relied upon that memoranda. Plaintiffs claimed that Wasserstrom was negligent in both the preparation of the memoranda and of the tax opinion letters, and that such negligence was

a proximate cause of their losses. Both plaintiffs claim that there was adequate evidence for the jury to find Wasserstrom negligent.

The claim of the plaintiff Eisenberg against defendant Weinstein was that Weinstein as general partner of the limited partnership in which Eisenberg was a limited partner, owed Eisenberg a duty of due care, and that Weinstein failed to meet that duty, which constituted negligence on Weinstein's part. Plaintiff Eisenberg further claims that the jury was entitled to find that Weinstein was responsible for the negligent misrepresentations and omissions in the offering memoranda. Thus, both plaintiffs argue that the jury's verdict is justified because both plaintiffs read and relied upon the offering memoranda.

As to plaintiff Nissen, he testified at trial that he had not read the entire prospectus before he invested. N.T. Cross Examination Volume, p. 5. Nissen also testified that he thought that a lot of the information in the offering memorandum was garbage. *Id.* He stated further that he skimmed much of the information in the prospectus. N.T. Cross Examination Volume, pps. 5, 6, 15. He said that he only really looked at some of the mathematics, and saw no sense reading about the risk because he knew there was a risk and he was fully aware of it. N.T. Cross Examination Volume, p. 6. He testified further that to him the only risk involved was that he was either going to lose his investment or he was not going to lose it. *Id.* He said that he wouldn't have become destitute had he lost his $15,000.00 investment. N.T. Cross Examination Volume, p. 7. Nissen added that the $15,000.00 investment sounded like a great deal to him because he would receive tax benefits of approximately $45,000.00, and in his 50% tax bracket, that would save him close to $20,000.00. N.T. Direct Testimony Volume, pps. 6, 14.

Plaintiff Eisenberg also testified that he did not carefully read the offering memoranda, and knew of the risks

involved. Eisenberg was also in the 50% tax bracket, and invested $12,500.00 to obtain a tax benefit.

After giving the plaintiff the benefit of all reasonable inferences capable of being drawn from the evidence, we conclude as a matter of law that the record lacks the minimum amount of evidence from which the jury could have reached its verdicts in favor of Nissen against Wasserstrom for negligence, and in favor of Eisenberg against both Wasserstrom and Weinstein for negligence.

The mere existence of negligence and the occurrence of injury are insufficient to impose liability upon anyone. There remains to be proved the vitally important link of causation, *Cuthbert v. Philadelphia*, 417 Pa. 610, 614 (1965). The plaintiff has the burden of proving the link, that defendant's negligence was the proximate cause of plaintiff's injury. *Id.*

The plantiffs in the case *sub judice* failed to present evidence that their loss was proximately caused by any negligence of the defendants Wasserstrom and Weinstein. Rather, the plaintiffs' own testimony revealed that not only did they not read the offering memorandum in its entirety, they did not rely upon its contents when they made their investments. Having failed to prove a causal connection between the negligence of the defendants Wassestrom and Weinstein as found by the jury, and their loss from their investments, the plaintiffs are not entitled to recover damages from Wasserstrom and Weinstein. We therefore grant the motions of Wasserstrom and Weinstein for judgment n.o.v.

There are other post-trial motions which we will not act upon in light of our granting the motions for judgment n.o.v. Those other motions are:

1. The motions of the plaintiffs to amend the judgment.

2. The motions of the defendants for remittur.

**IN THE UNITED STATES DISTRICT COURT**
**FOR THE EASTERN DISTRICT OF PENNSYLVANIA**

| | | |
|---|---|---|
| MARTIN EISENBERG and ARTHUR NISSEN, on behalf of themselves and all others similarly situated | : | |
| *vs.* | : | C.A. NO. 82-5051 |
| FREDERICK M. GAGNON, et al | : | |

MARCH 30, 1984

**ORDER**

1. The motion of the defendant David E. Wasserstrom for judgment n.o.v. is GRANTED.

2. Judgment is entered in favor of the defendant David E. Wasserstrom against both plaintiffs.

3. The motion of the defendant David Weinstein for judgment n.o.v. is GRANTED.

4. Judgment is entered in favor of the defendant David Weinstein against plaintiff Martin Eisenberg.

IT IS SO ORDERED.

CHARLES R. WEINER